Asset Protection for Hard Times

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The turmoil in the financial markets together with a steep recession is hitting most of my clients pretty hard. Some have lost more than half of their retirement savings by the plunge in both stocks and real estate values. And with business down almost everywhere many are concerned about the impact of the economy on their practice; will income and cash flow be squeezed over the next few years?

Much of our legal work now involves asking some tough questions to figure out whether there are any particular risks and potential dangers that we should be guarding against. Specifically, are there areas of your practice or outside investments which might increase your lawsuit liability risks? How should we structure business activities and personal assets to protect against the financial risks which are now posed?

Identifying New Risks

The first step in the planning process is to accurately identify and evaluate the extent of any new risks that may be presented by the changes in the economy.

Active Investments

If you are an active investor in a business or real estate project your liability risks are magnified by the current circumstances, particularly if you made a substantial real estate investment within the past few years. Now, with falling prices and a frozen credit market many are agonizing over the decision of whether to pump in more money to carry the deal or to call it quits and walk away from a rapidly sinking investment. The problem is that even if you walk away, you're still on the hook for the full amount of the loan and most lenders are not going to let you walk away, at least not if you have any assets left. What we've seen in our practice is that when the value of a property is less then the loan amount the lender will generally pursue any deficiency, unless specifically barred by state law (see our article "Protecting Against Real Estate Losses")Should you put in more money now and hope the market comes back or walk away and fight it out with the lender? A big part of that decision may come down to the strength of your prior legal planning.

Passive Investments

Even if you're not actively involved with an investment it's a good idea to understand what responsibilities you may have if things go wrong. What type of entity holds the investment, a corporation, limited partnership or limited liability company? Have you personally guaranteed any loans? Do you have an obligation under the operating agreements to contribute additional cash if needed? Is the manager of the business paying close attention or is he busy with other matters? Make sure you have a good handle on the current operations of all of your investments and are clear about potential risks and your obligations.

Medical Practice

What risks might be associated with the operation of your medical practice? Your malpractice liability probably doesn't change much but look into whether your liability insurer is still on solid financial ground or has been hurt by the stock or credit markets. Many of our clients are experiencing slower payments, more delaying tactics and more denials of coverage as health insurers fight to maintain their profits in a difficult climate. Some of my clients are oncologists who front enormous drug costs every month on fairly tight margins and they feel that any additional cutbacks or payment delays will seriously impact their practices. Even physicians without insurance concerns may face a decline in demand for discretionary treatment. Consider whether your practice is vulnerable to a squeeze in cash flow and whether you may need to increase your borrowings, if available, or out of pocket contributions.

Planning Strategies

In a tough recession business profits decline and potential obligations and liabilities increase. What approach should we take to protect against these risks? Before problems arise, make sure that appropriate legal planning insulates you from personal liability to the greatest extent possible. That means choosing the proper entity, perhaps an LLC or corporation for business activity. The type of entity you choose can seriously affect the extent of your liability. General partnerships usually provide the least protection and expose you to the greatest amount of risk. An LLC, in many situations, has the best level of protection with the fewest requirements and formalities.

After choosing the right entity for your business, make sure that personal assets exposed to a risk of loss from bad deals are insulated and shielded from potential claims. There are many strategies which can accomplish this result and you can see an outline of the basic planning in our previous articles (see our article "Asset Protection Strategies"). The goal of a sound legal structure should be to avoid jeopardizing accumulated (and future) savings from a business deal or something in your practice that ends up with unforeseen losses and liability. Discuss with your attorney whether your legal planning is up to date and appropriate for these tough new times.